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MidFirst Bank

October 15, 2001

ATTN: Docket No. 2001-49

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

Sir or Madam,

MidFirst Bank appreciates the opportunity to provide the OTS and other FFIEC members with comments regarding the Community Reinvestment Act. Before beginning, it is pertinent to note that Congress defined the scope and purpose of the Community Reinvestment Act (12 USC Sec. 2901) to be the credit needs of communities in which an institution operates.[1] The following outlines issues that deserve careful consideration.

Originated and Purchased Loans

MidFirst objects to arguments that purchased loans do not benefit a community's credit needs. Proponents arguing for the exclusion of purchased loans state that purchased loans do not offer the same opportunity for loan complexity and flexibility, that purchased loans do not require the same time commitment by the lender, and that purchased loans may distort a lender's true commitment to the community's credit needs. While these may in some cases be true, they do not negate the fact that the institution funded the loan, provided liquidity to the originating lender, and accepted credit risk. MidFirst acknowledges that purchased loans may create unusual situations from a CRA perspective including unbalanced loan concentrations in one geographic area or loan purchases during a concentrated period of time. These situations however do not detract from the fact that purchasing loans provides liquidity to originating lenders thereby increasing available funds for new originations.

MidFirst suggests that before removing purchased loans from CRA consideration, the Home Mortgage Disclosure Act and implementing Regulation C must be amended to remove purchased loans from the HMDA reporting requirement. Inconsistent consideration of purchased loans between HMDA and CRA creates the opportunity for regulatory "double jeopardy" given the public availability of this data; institutions would often be justifying their CRA commitment in terms of whichever position – CRA rating or purchased loan volume - is less flattering. If statute and regulation require the public dissemination of purchased loans through HMDA, the only equitable treatment would be to allow the lender to include purchased loans for CRA.

Assessment Area

MidFirst encourages re-evaluation of the concept of Assessment Area. With the significant increase in Internet banking applications and the expansion of telephone center operations and bank by mail programs, reliance on a bricks and mortar facilities is decreasing. Such technologies often provide an institution with a national or large regional market presence that extends far beyond the geographic location of an institution's offices. Nondeposit funding sources (including wholesale or brokered deposits, borrowings from the Federal Reserve or Federal Home Loan Banks, and other debt instruments) are becoming more important components of the balance sheet. These recent trends decrease the correlation between deposit and lending concentrations and reduce the relevance of an assessment area based primarily on deposit dispersions and branch networks.

If the concept of assessment area is retained, MidFirst suggests that each institution be granted the flexibility to define its own assessment area according to its business strategies rather than defining its assessment area based on a static bricks and mortar or deposit formula. While agreeing that regulators should be wary of conspicuous gaps of low- or moderate-income tracts from an assessment area, MidFirst suggests that an assessment area need not be restricted to an MSA or contiguous political subdivisions. MidFirst also opposes the mandate requiring separate assessment areas and ratings for contiguous or relatively contiguous geographies bisected by a state line. MidFirst suggests consideration be given either a) to permitting designation of a single assessment area regardless of the geographies involved or b) to allowing evaluations to be based on the institution's record within all assessment areas as opposed to the current system which requires ratings for each assessment area. It is wrong to penalize an overall "Satisfactory" or "Outstanding" performance by a slightly inferior performance in one part of an assessment area.

This more flexible approach to assessment area, however, does not come without concerns that must be addressed. For example, a lender that generates a significant number of HMDA loans and perhaps deposits via the internet may have an assessment area that extends significantly beyond its branch network – perhaps all of the lender's offices are in a single state but the loans are generated from eight or ten other states some of which are not contiguous to the home state. In this situation, the lending dispersion justifies the assessment area extending beyond the home state, yet attempting to provide service and/or investments to these other states may be difficult or impossible to accomplish in a reasonable, controlled, and safe and sound manner. This same scenario may be evident on a county-by-county basis within a state by smaller lenders.

In summary, MidFirst suggests that institutions be allowed to define their own assessment areas by means of their own choosing provided the assessment area is reasonably consistent with the strategies as defined by the institution. Whether the assessment area is defined by branch offices, deposit dispersions, loan dispersions, another product or strategy, or some combination of the foregoing should be at the individual institution's discretion provided the institution can support the reasonableness of the assessment area. MidFirst also suggest that the term "community" as used in the statute and regulation regarding assessment area not be deemed a small or limited geographic area per se; in some situations, "community" might be a regional, multi regional, or perhaps even a national area.

Harmful or Abusive Terms

MidFirst opposes an expansion of regulations beyond their original scope. CRA is designed to address the distribution of loans across geographic areas. Adequate data, both that which is publicly released and that which is available to regulators during examinations, is generated to afford regulators the ability to adequately assess an institution's lending patterns for both CRA and Fair Lending purposes. As MidFirst argued in responding to the Banking Agency's request for comment in expanding the HMDA and HOEPA requirements[2], additional HMDA and HOEPA reporting and CRA analysis to account for abusive patterns is unnecessary and does not afford a reasonable cost-benefit solution for institutions, the regulators, or the public. Existing laws and regulations including Equal Credit Opportunity Act (15 USC 1691 *et seq.*), the Fair Housing Act (42 USC 3601, *et seq.*) and the implementing regulations provide adequate enforcement tools in relation to fair lending.

Fair Lending Examinations are generally performed concurrently with CRA Examinations and often by members of the same examination team. The likelihood of these concurrent examinations increases for institutions that have previously performed poorly in either CRA or Fair Lending or that are expected to receive poor ratings based on off-site/pre-examination scoping reviews. Even when CRA Examinations occur separately from a Fair Lending Examinations, regulators have the authority to expand scope by initiating a Fair Lending Examination. In short, regulators have ample authority and resources to adequately address Fair Lending concerns without expanding CRA to include abusive lending.

Investment Test

MidFirst opposes the current investment test structure given the investment limitations imposed on savings associations vis-à-vis banks. Although MidFirst notes that savings associations will receive a minimum low satisfactory rating on the Investment Test given at least a satisfactory Lending Test grade, there is no provision to receive a higher rating. MidFirst proposes that savings associations that are doing the best they can within regulatory confines should receive an outstanding rating on the Investment Test regardless of the level and activity in relation to peer.

MidFirst is concerned that limited availability for CRA related investments has allowed CRA premiums to be charged that serve as disincentives to acquiring such investments. At a minimum these practices reduce the profitability of a given investment. While "profitability" is not explicitly defined in the regulation, it is important to note that institution's have profitability objectives that are generally well above break even. These premiums may reduce an institution's return to a point that is below its profitability requirements and which arguably would provide justification, supported by regulation, not to invest.[3]

MidFirst also notes the subjectivity associated with the Investment (and Service) Test. There is no established standard for determining what produces a particular rating. Those opposing the development and publication of specific standards[4] for certain ratings argue that pre-established and publicized standards a) would serve as a disincentive for institutions to engage in activities above the minimum required for a particular rating, b) would not allow institution's to receive credit for flexibility or innovation, or c) would minimize the effort institutions expend on less tangible CRA activities. MidFirst is not suggesting that credit for innovation or complexity should necessarily be eliminated; however, when judging the benefit that a CRA investment provides to a community, the most pertinent aspect is the dollar impact. Institutions are favorably disposed to fund projects requiring lower levels of overhead, analysis, and management oversight – complexity - since the return to the institution would be higher. Improved returns would be an incentive for additional investment thereby increasing the community benefit.

MidFirst is concerned with the idea that only investments acquired since the previous examination qualify for CRA credit. MidFirst is also concerned with the potential to receive "negative" CRA credit for liquidations of CRA investments made during prior examination periods. Many investments have long periods until maturity or have lower returns on equity or investment.[5] As a result, CRA investments may not be consistent with institution profitability goals, risk management objectives, or strategies particularly given that these goals may change with the passage of time. With the long term to maturity and a requirement to continue purchasing these investments for each examination period, a CRA investment portfolio will grow over time thereby generating a more significant inconsistency with institution goals and objectives. MidFirst encourages specific guidance that allows for institutions to receive credit for the outstanding balance of CRA investments made in prior review periods. MidFirst also requests that liquidations of CRA investments be a neutral CRA event specifically since the precedence exists for institutions to sell HMDA (CRA) loans without negative consequence.

MidFirst does not oppose institutions receiving CRA credit for innovation or complexity; however, MidFirst does oppose the language in which an "extensive" level of innovation and complexity be demonstrated for an outstanding rating.[6] While innovation and complexity are less important elements in providing CRA credit to a community vis-à-vis funds provided; the problem is exacerbated by the lack of definitions for "innovation" and "complexity". Further exacerbating the problem is the lack of definition for the descriptions associated with a particular rating for a particular criteria; for example, no one knows what a "significant" level of innovation is or what an "occasional" level of complexity is. This not only reduces focus on the importance of funding but it affords the opportunity for inconsistent ratings.

While downplaying the importance of innovation and complexity in relation to actual dollars, MidFirst acknowledges that in some cases, these may be productive elements of a CRA investment program. Institution's engaging in complex and innovative investments should receive credit for such activities, and institution's with complex and innovative investments should have the ability to receive a given rating with a lower dollar amount of CRA investments. Finally, the dollar amount of CRA investments, regardless of complexity and innovation, should be a sufficient basis to achieve any of the five ratings. MidFirst also emphasizes that a quantifiable and tangible guideline for each rating (dollar, ratios to equity, etc.) must be established and publicized.

Affiliates and Subsidiaries

To extend the Community Reinvestment Act to affiliates and subsidiaries would require amendment of the Act itself.[7] MidFirst believes that such an extension would serve no valid purpose and would only increase the costs associated with compliance. Affiliates often have no direct operational or strategic relationship, other than a common parent(s), to the insured institution; CRA is not a relevant issue for these affiliates. By increasing the entities within a corporate structure that are subject to CRA would unnecessarily require an increase in the CRA commitment of the institution. While a CRA commitment itself is a good goal, the corporate entity, and in particular the insured institution, should not be subjected to increased CRA activities and regulatory burden simply based on association with sister entities.

Service Test

Activities associated with the Service Test often generate lending opportunities; for example, a branch facility affords the opportunity to generate loan applications and supporting homebuyer education generates contact with potential applicants. Further, MidFirst opines that the success an institution has with Service activities will be reflected in the loan volumes. CRA Service activities are an outreach effort with similar goals as loan officer cold calls and general advertising. MidFirst therefore suggests that consideration be given to removing the Service Test from CRA. While there is certainly no one-to-one correlation between service activities and loan volumes, it is logical to consider that increased service activities effectively pursued will increase loan volumes. As a result, the Lending Test rating provides a basis for measuring ancillary CRA related activities and therefore makes the Service, and Investment, Tests less meaningful.

The existing criteria used to evaluate an institution under the Service Test require reconsideration. For example, opening and closing branch offices, branch hours, and delivery channels all attempt to gauge how effectively an institution serves the public; in fact, the first two seem to be a component of the third, yet institutions are measured under each individually. These also tend to place extraordinary focus on a branch network whereas telephone or Internet strategies for some institutions may be the dominant channels.

Another concern relates to the emphasis of branches and the record of opening and closing. The criteria and rating descriptions suggest that an institution's record of branch openings and closings should either be in response to credit needs or be adequately balanced across customer and geographic income levels. Depending on an institution's unique circumstances, the record of opening and closing branches may have no impact on a community's credit needs. Further, an institution undergoing expansion may open branches only in one income category, for instance middle, and that expansion may be significant, yet that alone is insufficient to suggest that the institution's response to the credit needs of lower income areas is inadequate.

MidFirst opposes specific regulatory requirements associated with a "HMDA-like" geocoding and assessment of an institution's deposit base. Institutions are currently able to perform this type of analysis on an as needed basis; however, to create a specific requirement that institutions perform this detailed analysis on a prescribed basis or to publicly report this level of detail is beyond the scope and purpose of CRA. This type of burden only increases institution expenses which then affects the pricing of products and services.

Community Development

MidFirst is concerned with the definition of Community Development and the ability to receive Community Development credit. The most noted example is the overlap between small business and farm lending and community development lending since a loan can be reported only in one category[8] with small business and farm receiving precedence. As a result, smaller dollar loans meeting the community development definition do not qualify for inclusion in the community development category simply because of their size. MidFirst opines that any activity generating CRA credit and eligible for inclusion in the CRA Performance Evaluation, whether under the existing Lending, Service, or Investment Test, should qualify as Community Development.

Small and Large Institutions

The small institution CRA examination procedures provide an adequate mechanism to assess CRA compliance for institutions under $250 million in assets; the pertinent question is whether the small institution procedures, or some combination of the two methodologies, would provide a reasonable assessment for all institutions regardless of asset size. As currently structured, small institutions are assessed under five separate criterion whereas large institutions are assessed under 14 separate criterion; additionally, the assessment criteria for large institutions requires significantly greater institution resources to prepare, analyze, and document CRA compliance. Therefore the regulatory burden and associated costs[9] under the large institution CRA examination procedures significantly exceed the costs to comply with the small bank CRA examination procedures. MidFirst asks that the Agencies consider the burden, costs, and potential for competitive disadvantage in relation to the marginal benefits derived under the large institution methodology. If the Agencies determine that this cost benefit analysis does not produce a positive result, consideration should be given to applying small institution procedures to all institutions; only after this analysis is complete can any determination be made regarding the adequacy of the $250 million threshold. MidFirst is concerned that a significant increase in the threshold without addressing these issues will be counterproductive and anticompetitive.

Sincerely,

Charles R. Lee
Vice President and
Director of Bank Administration

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1 Excerpts from the Community Reinvestment Act 12 USC 2901 *et seq.*:

2901(b) - "It is the purpose of this chapter . . . to encourage such institutions to help meet the credit needs of the local communities in which they are chartered. . ."

2903(a) – "In connection with its examination of a financial institution, the appropriate Federal financial supervisory agency shall – (1) assess the institution's records of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation . . ."

2906(b) states that the Assigned Rating "shall be 1 of the following:

(A) 'Outstanding record of meeting community credit needs'.
(B) 'Satisfactory record of meeting community credit needs'.
(C) 'Needs to improve record of meeting community credit needs'.
(D) 'Substantial noncompliance of meeting community credit needs'. "

2 Board of Governors of the Federal Reserve Proposed Rule and Proposed Staff Interpretation for Home Mortgage Disclosure Act, R-1001 dated December 8, 2000, and MidFirst's response dated March 8, 2001.

3 12 CFR 563e.21(d) "To the contrary, the OTS anticipates savings associations can meet the standards of this part with safe and sound loans, investments, and services on which the savings associations expect to ma a profit."

4 For example, without promoting any particular standard, an investment to equity ratio of 1.0 percent for a CRA (d) examination review period might generate a particular rating.

5 Examples that lower the return include premiums associated with many CRA investments and the added project oversight requirements associated with "complex" or "innovative" investments.

6 MidFirst's opposition extends to the definitions associated other ratings as well.

7 12 USC 2902(2) defines regulated financial institution to mean "an insured depository institution as defined in section 1813 of this title [see below]."
12 USC 1813(c)(2) Insured depository institution. – "The term "insured depository institution" means any bank or savings association the deposits of which are insured by the Corporation pursuant to this chapter."

8 With the exception of multifamily loans potentially qualifying as both HMDA and Community Development.

9 Though increased loan reporting requirements, expanded internal CRA analysis, and more frequent examination cycles.